(2)

No. 91-1655

In the Supreme Court of the United States

OCTOBER TERM, 1991

CHARLA GATES CANNON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Tax Court properly looked to the provisions of Section 183 of the Internal Revenue Code, 26 U.S.C. 183, in determining the allowability of mining expense deductions claimed by the partnership in which petitioner was a partner.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A34-A48) is reported at 949 F.2d 345. The memorandum opinion of the Tax Court (Pet. App. A5-A29) is unofficially reported at 59 T.C.M. (CCH) 164.

JURISDICTION

The judgment of the court of appeals was entered on November 15, 1991. The petition for rehearing was denied on January 13, 1992 (Pet. App. A49-A50). The petition for a writ of certiorari was filed on April 13, 1992 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In 1973, petitioner acquired an interest in a limited partnership (VEMCO), which decided to finance a Mexican gold and silver mining venture to be conducted by third parties. Petitioner provided VEMCO with the funds needed to finance the mining operations. Petitioner was to receive a higher percentage of VEMCO's profits or proceeds than her partners, and the partnership's annual expenses and losses were allocated to petitioner to the extent that her capital account permitted (Pet. App. A36). During the four years involved in this case, VEMCO received no income from its investment in the mining venture (*id.* at A36-A37).

Petitioner deducted her distributive share of the partnership losses on her federal income tax returns for 1976, 1977, 1978, and 1979. The Commissioner disallowed these deductions because petitioner had not established that these amounts were ordinary and necessary business expenses or were expended for an activity entered into for profit or for the production of income (Pet. App. A37).

2. Petitioner sought a redetermination in the Tax Court of the deficiencies asserted against her, contending that the expenses were deductible under Sections 162, 165, 212, 616, or 617 of the Internal Revenue Code (Pet. App. A17-A18). At trial, the Commissioner reiterated his position that petitioner had the burden of proving that the expenses for which VEMCO claimed deductions were incurred for the purpose of realizing an economic profit. Petitioner introduced evidence in an attempt to meet that burden, including her own testimony regarding her desire to "make money" and the profitability of other business ventures in which she had engaged. She also

sought to rely on an expert's report containing profit projections that had been prepared for VEMCO.[1]

The Tax Court found that VEMCO had not engaged in the mining activities with a bona fide profit objective. The court therefore concluded that petitioner was not entitled to deduct the claimed losses (Pet. App. A19-A21).[2] Although neither party had made reference to Section 183 of the Internal Revenue Code in their briefs to the Tax Court, the court cited Section 183(c), entitled "ACTIVITIES NOT ENGAGED IN FOR PROFIT DEFINED," and considered the factors enumerated in Treas. Reg. § 1.183-2(b) in determining that the mining activity was not one engaged in for profit (Pet. App. A19-A24).

3. Petitioner sought reconsideration by the Tax Court of its decision, arguing that she was unfairly surprised and prejudiced by the court's application of Section 183 and the factors listed in Treas. Reg. § 1.183-2(b). The Tax Court denied her motion.

The court of appeals affirmed. The court concluded "that the Tax Court's reliance on section 183 was proper and that the court's findings regarding partnership motives were not clearly erroneous" (Pet. App. A35).

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[1] The parties also introduced evidence regarding other grounds advanced by the Commissioner for disallowance of the partnership's deductions, including whether the expenses were development expenses under Section 616, capital contributions to Mexican corporations in which VEMCO was a shareholder, or the expenses of the Mexican corporations rather than of VEMCO (Pet. App. A7, A25-A27).

[2] The court first concluded that petitioner was not entitled to deduct the expenses under Sections 162 and 165 of the Code because neither she nor VEMCO was directly engaged in the business of mining in Mexico (Pet. App. A18-A19).

ARGUMENT

The court of appeals correctly held that the Tax Court properly considered Section 183 of the Code and the factors enumerated in Treas. Reg. § 1.183-2(b) in determining whether VEMCO entered into the mining activity that generated the losses in question with the objective of making a profit. The decision of the court of appeals does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. Section 183(a) of the Code provides, as a general rule, that no deduction attributable to any activity shall be allowed if the activity is not engaged in for profit. See 26 U.S.C. 183(a). The term "activity not engaged in for profit" is defined in Section 183(c) as "any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212." 26 U.S.C. 183(c). Contrary to petitioner's contention (Pet. 4-5), Section 183 is inherently interrelated with Sections 162 and 212, for it defines the critical term "activity not engaged in for profit" by reference to deductions permitted under those two provisions. See Pet. App. A38.

Section 162 permits the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. 26 U.S.C. 162. To be engaged in a trade or business, "the taxpayer's primary purpose for engaging in the activity must be for income or profit." *Commissioner* v. *Groetzinger*, 480 U.S. 23, 35 (1987). See also *Thomas* v. *Commissioner*, 792 F.2d 1256, 1259 (4th Cir. 1986). Section 212 allows the deduction of ordinary and necessary expenses paid or incurred in the production or collection of income or in the management, conservation, or maintenance of property held for the production of income. 26 U.S.C. 212. As un-

der Section 162, a deduction is available under Section 212 only for activities or transactions entered into primarily for profit. See, *e.g.*, *Wrightsman* v. *United States*, 428 F.2d 1316, 1320 (Ct. Cl. 1970); *Carkhuff* v. *Commissioner*, 425 F.2d 1400, 1404 (6th Cir. 1970).

The Commissioner disallowed the deductions claimed by VEMCO on the ground that petitioner had failed to establish that VEMCO's activities were engaged in primarily for profit (Pet. App. A37). It was therefore petitioner's burden to demonstrate that the requisite profit motive existed. *Independent Electric Supply, Inc.* v. *Commissioner*, 781 F.2d 724 (9th Cir. 1986); *Dreicer* v. *Commissioner*, 665 F.2d 1292 (D.C. Cir. 1981). In determining whether petitioner had met her burden of proof, the Tax Court considered the factors set forth in the regulations promulgated under Section 183 (Treas. Reg. § 1.183-2(b)).[3] In doing so, the court acted in accordance with a long line of appellate authority.[4] *Antonides* v. *Commissioner*, 893 F.2d 656, 659 (4th Cir. 1990) (the "profit

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[3] Treasury Regulations § 1.183-2(b) lists nine factors that may be considered in determining whether an activity was engaged in for profit. No single factor, nor the existence of a majority of the factors, is necessarily determinative in any given case. *Ibid.*; *Nickerson* v. *Commissioner*, 700 F.2d 402, 404 (7th Cir. 1983). The factors listed in the regulations were derived principally from the case law developed prior to enactment of Section 183. See *Faulconer* v. *Commissioner*, 748 F.2d 890, 894 (4th Cir. 1984).

[4] The regulations under Section 212 (Treas. Reg. § 1.212-1(c)) indicate that the inquiry as to profit motive under that Section is to be determined by reference to Section 183 and the regulations issued thereunder. This cross-reference to the regulations under Section 183 belies petitioner's claim that the profit standard under Section 183 is different from that under Section 212.

motive required by section 183 [is] the same as the profit motive required by sections 162 and 212"); *Faulconer* v. *Commissioner*, 748 F.2d 890, 893 (4th Cir. 1984) (the "regulations under section 183 * * * explicate the profit-motive requirements of sections 162 and 212"); *Tallal* v. *Commissioner*, 778 F.2d 275, 276 (5th Cir. 1985) (criteria in regulations under Section 183 used to determine whether partnership had bona fide profit motive under Section 162); *Hayden* v. *Commissioner*, 889 F.2d 1548, 1552 (6th Cir. 1989) (referring to Section 183 in determining existence of profit motive); *Independent Electric Supply, Inc.* v. *Commissioner*, 781 F.2d 724, 726-727 (9th Cir. 1986) ("the courts have relied on the section 183 factors in conducting the profit motive analysis under section 162"); *Brannen* v. *Commissioner*, 722 F.2d 695 (11th Cir. 1984) (applying factors listed in regulations under Section 183 to determine whether taxpayer's activities were engaged in for profit under Section 162); *Dreicer* v. *Commissioner*, 665 F.2d 1292, 1294 (D.C. Cir. 1981) ("a taxpayer claiming a deduction under Section 162 or 212 for an expense, or under Section 165 for a loss, must be prepared to demonstrate an associated profit motive in order to avoid the ban of Section 183").

The Fifth Circuit has explicitly rejected the claim that it is error for the Tax Court to consider the regulations under Section 183 in determining whether the requisite profit motive existed. *Agro Science Co.* v. *Commissioner*, 934 F.2d 573, 576 (5th Cir.) ("contrary to [taxpayer's] assertion, the Tax Court appropriately looked to the factors listed in 26 C.F.R. § 1.183-2(b) (1990) in discerning profit motive bona fides"), cert. denied, 112 S. Ct. 300 (1991). There is no authority for petitioner's claim that the Tax

Court erred by considering the Section 183 regulations in this case.

2. Petitioner's reliance on cases holding that the Tax Court may not decide a case on a new issue raised for the first time after trial (Pet. 6) is misconceived. As the court of appeals correctly concluded in this case (Pet. App. A39), the application of Section 183 and the factors enumerated in the accompanying regulations to the profit motive inquiry did not present a new issue, for VEMCO's profit motive was at issue throughout the case. The notices of deficiency issued to petitioner by the Commissioner raised the absence of a profit motive as one of the grounds for the disallowance of the claimed partnership deductions (*ibid.*). The Commissioner's counsel emphasized in opening statement at trial that it was incumbent upon petitioner to prove that the expenditures were incurred for a profit motive (*ibid.*). Petitioner's counsel also recognized at trial that the critical question in the case was the motive for the mining activties that generated the disputed loss deductions (*ibid.*).

There was thus no new issue involved. Instead, the Tax Court simply considered the factors enumerated in Treas. Reg. § 1.183-2(b) in deciding the issue that was central to the case. As the court below correctly concluded, application of those factors in considering the profit motive issue was "predictable and nonprejudicial" (Pet. App. A41).[5]

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[5] Petitioner could not, in any event, have been prejudiced by the Tax Court's reliance on the factors enumerated in Treas. Reg. § 1.183-2(b) because those factors are derived from case law developed prior to enactment of Section 183. See *Faulconer* v. *Commissioner*, 748 F.2d at 894; *Benz* v. *Commissioner*, 63 T.C. 375, 383 (1974).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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